91-886

(1)

No.

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1991

BOB REVES, ROBERT H. GIBBS, and FRANCES GRAHAM, As Representatives of a Class of Note Holders,

Petitioners,

v.

ERNST & YOUNG,

Respondent.

PETITION FOR A WRIT OF CERTIORI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Did the Eighth Circuit err when it held, in conflict with other courts of appeals, that the phrase "to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs" in section 1962(c) of the RICO statute requires proof that the defendant managed or operated the enterprise?

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OPINIONS BELOW

The opinion of the U.S. Court of Appeals for the Eighth Circuit is reported at 937 F.2d 1310, and is included in pertinent part in the Appendix at A-1. The summary judgment opinion of the U.S. District Court for the Western District of Arkansas is unreported and is included in pertinent part in the Appendix at A-50.

JURISDICTIONAL GROUNDS

On June 27, 1991, the Eighth Circuit affirmed in part and reversed in part the judgment of the district court. On August 29, 1991, the Eighth Circuit denied Ernst & Young's petition for rehearing. This Court has jurisdiction to review the judgment below by writ of certiorari pursuant to 28 U.S.C. § 1254(1). The courts below had federal jurisdiction pursuant to 28 U.S.C. § 1331.

STATUTE INVOLVED

The statute involved in this petition is 18 U.S.C. § 1962(c) of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), which provides:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

STATEMENT OF THE CASE

In 1990, this Court granted our petition for a writ of certiorari in order to determine the proper test for deciding whether or not a particular "note" is a "security." We now ask this Court to resolve a well-developed conflict among the courts of appeal over the level of participation necessary to subject a defendant to RICO liability under 18 U.S.C. § 1962(c).

The petitioners are the members of a Class of small investors (the "Class") who purchased demand notes issued as investment securities by a now-bankrupt farmers' cooperative organization (the "Co-op"). The Class sued certain local employees of Arthur Young & Co., now Ernst & Young (for consistency, "Arthur Young") for, among other things, violating state and federal securities laws and the

Racketeer Influenced and Corrupt Organizations Act ("RICO"). Only the RICO claim is relevant to this petition. In its RICO claim, the Class alleged, among other things, that Arthur Young participated in the conduct of the affairs (especially the ongoing sale of demand notes) of the Co-op (the RICO enterprise) and, in doing so, engaged in a continuous pattern of securities and mail frauds.

Arthur Young became involved with the Co-op in 1980. Over the next several years, it created and perpetuated a fraud that deprived over a thousand investors of millions of dollars. The Co-op raised its operating capital through the sale of uninsured and uncollateralized demand notes to thousands of unsophisticated individual investors. Arthur Young realized that the sale of demand notes was vital to the continued operation of the

Co-op, which at the time was Arthur Young's largest local account. Arthur Young also discovered that the Co-op was insolvent. Faced with this dilemma and hoping that the Co-op could recover over time, Arthur Young devised a scheme to make the Co-op appear solvent in order to allow the Co-op to continue to sell demand notes. The scheme worked for over two years, during which the Co-op sold millions of dollars in largely worthless securities. (See Appendix at A-6 to A-42.)[1]

Arthur Young exercised sole control over the presentation of the Co-op's financial condition to the Co-op's directors, the investors in the demand

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[1] The Eighth Circuit reviewed the facts of this case in great detail, (see Appendix at A-6 to A-44), and we address only the most salient points here.

notes, and the general public. Arthur Young intentionally prepared false financial statements, did not disclose to the Co-op's board of directors the false assumptions used by Arthur Young, knowingly made misleading presentations on the Co-op's financial affairs at the Co-op's annual meetings attended by members and investors, presented false summary reports on the Co-op's financial health at the annual meetings, and concealed its fraud from the Co-op's directors and investors. (See Appendix at A-20 to A-34.)

In 1986, the district court entered summary judgment against the Class on its RICO claim. The court relied on Bennett v. Berg, in which the Eighth Circuit en banc held that section 1962(c) of the RICO statute requires that a defendant have "some participation in the

operation or management of the enterprise itself."[2] The district court concluded that Arthur Young's activities did not "satisfy the degree of management required by Bennett v. Berg." (See Appendix at A-58 to A-60.)[3]

In 1987, after a five-week trial on the securities claims, the jury concluded that Arthur Young had "originated" a fraud and ran it for two

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[2] 710 F.2d 1361, 1364 (8th Cir.) (en banc) (citation omitted), cert. denied, 464 U.S. 1008 (1983).

[3] In ruling against the Class, the district court also relied on the Eighth Circuit's formulation of RICO's "pattern" requirement at that time, Superior Oil Co. v. Fulmer, 785 F.2d 252 (8th Cir. 1986). (See Appendix at A-61 to A-78.) This Court expressly rejected Superior Oil in H.J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229 (1989), however, and the Eighth Circuit's most recent decision in this action was not based on any failure to comply with the "pattern" requirement.

and a half years. The jury decided that Arthur Young was liable to the Class for approximately $6.1 million in compensatory damages. On appeal, Arthur Young contested its liability under the securities laws, while the Class argued that the entry of summary judgment against its RICO claim was in error, particularly in light of Arthur Young's commission of a series of securities frauds over nearly three years.

In 1988, the Eighth Circuit overturned the jury's award, concluding that the Co-op's notes were not securities (and thus never reaching the RICO issue because it held there were no predicate acts). In 1990, this Court reversed the Eighth Circuit's decision, holding that the court of appeals had applied an incorrect legal standard and that the

Co-op's demand notes were securities. 494 U.S. 56, 110 S. Ct. 945.

In 1991, on remand, the Eighth Circuit issued a lengthy opinion affirming the judgment against Arthur Young on the Class' federal and state securities claims. The court expressly stated that it was not formulating a broad theory of accountant liability: "We certainly doubt that other accounting firms will engage in the type of conduct that Arthur Young did in this case. More particularly, we hope that Arthur Young will not." 937 F.2d at 1333.

The court of appeals also affirmed the district court's grant of summary judgment against the Class' RICO claim, holding that it had no choice but to follow the Eighth Circuit's decision in <u>Bennett</u>: "We are aware of the inconsistencies between the circuits

regarding the necessary level of participation for RICO liability. . . . But until the Supreme Court rejects our standard or this court en banc overrules Bennett, we are bound to follow that decision." 937 F.2d at 1324; Appendix at A-47 to A-48.

REASONS FOR GRANTING THE WRIT

I. INTRODUCTION

The RICO statute provides for liability for those who "conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs." 18 U.S.C. § 1962(c). In determining the level of participation necessary for RICO liability, the courts of appeals have formulated three distinct and inconsistent tests. The Eighth Circuit, as well as the D.C. Circuit, require proof that a RICO defendant in some manner managed or operated the enterprise. This test conflicts directly with the test that has been adopted in the Second, Third and Ninth Circuits, the test that is employed in the Fifth, Sixth and Seventh Circuits, and the approach of the Eleventh Circuit.

Had the Class' claim been scrutinized under any test other than the Eighth Circuit's, the Class would have been able to present its RICO claim to the jury. The Eighth Circuit's participation test is inconsistent with the language and purposes of the RICO statute and should be rejected. In doing so, this Court should announce the proper test, which then can be applied by all the circuits.

II. THIS COURT SHOULD RESOLVE THE CONFLICT AMONG THE COURTS OF APPEALS AND DETERMINE THE LEVEL OF PARTICIPATION NECESSARY FOR RICO LIABILITY.

Over the past twelve years, the courts of appeals have formulated three different tests for determining the level of participation in the conduct of a RICO enterprise's affairs that can give rise to

a violation of section 1962(c).[4] The Class believes that both the Second Circuit's test and the Fifth Circuit's test are consistent with RICO's language and purposes.

According to the Second Circuit's test, the "participation" element is present where "(1) one is enabled to commit the predicate offenses solely by virtue of his participation in the enterprise or involvement in or control over the affairs of the enterprise, or (2) the predicate offenses are related to the activities of that enterprise."[5] The

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[4] See D. Abrams, The Law of Civil RICO § 4.7.3, at 232-42 (1991).

[5] United States v. Scotto, 641 F.2d 47, 54-55 (2d Cir. 1980), cert. denied, 452 U.S. 961 (1981).

Second Circuit's test has been adopted by the Third and Ninth Circuits.[6]

If the Second Circuit's test governed this action, the Class would be entitled to present its RICO claim to a jury. There is at least a genuine issue of material fact as to whether (1) Arthur Young was able to commit the predicate acts of securities fraud by virtue of its involvement in the financial affairs of the Co-op, or (2) the predicate acts of fraud were related to the conduct of the Co-op's demand note investment program.[7]

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[6] United States v. Yarbrough, 852 F.2d 1522, 1544 (9th Cir.), cert. denied, 488 U.S. 866 (1988); United States v. Provenzano, 688 F.2d 194, 200 (3d Cir.), cert. denied, 459 U.S. 1071 (1982).

[7] In its securities law analysis on remand, the Eighth Circuit held that "Arthur Young 'materially aided' in the sale of the demand notes." 937 F.2d at 1326.

The second "participation" test originated in the Fifth Circuit. According to that test, where the enterprise is a legitimate business, the "participation" element of section 1962(c) requires that "(1) the defendant has in fact committed the racketeering acts as alleged; (2) the defendant's position in the enterprise facilitated his commission of the racketeering acts; and (3) the predicate acts had some effect on the lawful enterprise."[8] The Fifth Circuit test has been followed by the Sixth and Seventh Circuits.[9]

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[8] United States v. Cauble, 706 F.2d 1322, 1333 (5th Cir. 1983), cert. denied, 465 U.S. 1005 (1984).

[9] United States v. Pieper, 854 F.2d 1020, 1026 (7th Cir. 1988); United States v. Qaoud, 777 F.2d 1105, 1115 (6th Cir. 1985), cert. denied sub nom. Callanan v. United States, 475 U.S. 1098 (1986).

Again, the Class would at least reach a jury under the Fifth's Circuit's test. First, it now is settled that Arthur Young committed a series of acts constituting securities fraud. Second, there is ample evidence that Arthur Young's position as auditor of the Co-op facilitated its commission of the securities frauds. Third, it is beyond dispute here that Arthur Young's fraud had "some effect" on the Co-op's ability to continue its demand note investment program.

The third test is the one that actually was applied to defeat the Class' RICO claim. The Eighth Circuit's test, as stated in Bennett, requires that a RICO defendant must "participat[e] in the 'operation or management of the enterprise

itself.'"[10] The D.C. Circuit, sitting en banc, recently rejected the Second Circuit and Fifth Circuit tests and adopted the Eighth Circuit's test; the D.C. Circuit concluded, "In order to participate in the conduct of an enterprise's affairs . . . a person must participate, to some extent, in 'running the show.'"[11]

The Class believes that the practical effect of the Eighth's Circuit test is that in two courts of appeals, accountants and other outsiders associated with an enterprise almost never can be subject to RICO liability; though outsiders may use an enterprise as a vehicle through which to commit a pattern

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[10] 710 F.2d at 1364.

[11] Yellow Bus Lines v. Drivers, Chauffeurs & Helpers Local Union 639, 913 F.2d 948, 954 (D.C. Cir. 1990) (en banc), cert. denied, 111 S. Ct. 2839 (1991).

of illegal acts, they probably will not direct the day-to-day operations of the enterprise. In contrast, accountants and other outsiders not directly involved in "running the show" of the enterprise, but who use their involvement in the enterprise to perpetrate a pattern of illegal acts, may be subject to RICO liability in seven other circuits.

The Eleventh Circuit has expressly rejected the Eighth Circuit's "management or operation" test in a case that is indistinguishable from this case.[12] In Bank of America v. Touche Ross & Co., 782 F.2d 966, 970 (11th Cir. 1986), the court stated flatly, "It is not necessary that a

[12] The Eleventh Circuit has not yet expressly adopted either the Second Circuit or the Fifth Circuit test. See United States v. Carter, 721 F.2d 1514, 1527 & n.16 (11th Cir.), cert. denied, 469 U.S. 819 (1984).

RICO defendant participate in the management or operation of the enterprise." Thus, the Eleventh Circuit held that the plaintiff stated a valid cause of action under RICO against the defendant accounting firm, which allegedly assisted in preparing and disseminating false financial statements that induced banks to lend money to the enterprise. Here, Arthur Young's activities went far beyond those of the accountants in Bank of America.

The Bank of America decision directly conflicts with the decision below and shows that in determining the presence of RICO's "participation" element, the courts of appeals have reached inconsistent results under essentially the same circumstances. Whether an accounting firm may ever be liable under RICO should not depend on whether the audit is

conducted in Arkansas or Alabama. This Court therefore should intervene and decide the proper test to be applied by all courts of appeals.

III. THIS COURT SHOULD REJECT THE EIGHTH CIRCUIT'S TEST.

This Court should reject the Eighth Circuit's "management or operation" test, which is contrary to the plain language of section 1962(c), inconsistent with the stated purposes of the RICO statute, and incompatible with this Court's dictum in H.J. Inc..

The language of section 1962(c) is broad enough to subject to RICO liability those defendants who are associated with, but not necessarily employees of, an enterprise and who participate, even indirectly, in the conduct of the enterprise's affairs. *See* 18 U.S.C. § 1962(c). There is nothing in this provision that requires any degree of management or operation; indeed, the statute expressly includes those who

"conduct" the enterprise's affairs and also those who "participate," whether "directly or indirectly," in conduct of these affairs.[13] In rejecting the "multiple scheme" restriction that the Eighth Circuit had formulated for RICO cases, this Court stated that those words "appear nowhere in the language or legislative history."[14] Likewise, the Eighth Circuit's test here wrongly would read the words "management or operation"

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[13] Admittedly, the RICO statute is not a model of legislative draftsmanship. Perhaps the most obvious example is that the word "conduct" appears in section 1962(c) as both a noun and a verb. Nevertheless, in each instance the meaning of the word is apparent from the context in which it is used.

[14] H.J. Inc., 492 U.S. at 240-41.

into the plain language of the RICO statute.[15]

Furthermore, the Eighth Circuit's test is inconsistent with this Court's instruction that "RICO is to be read broadly" in keeping with "Congress' self-consciously expansive language and overall approach." Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 497-98 (1985). As this Court has recognized, "Congress drafted RICO broadly enough to encompass a wide range of criminal activity, taking many different forms and likely to attract a broad array of perpetrators operating in

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[15] See, e.g., United States v. Garner, 837 F.2d 1404, 1420 (7th Cir. 1987) ("RICO does not require that the defendants actually manage or operate the enterprise. This court's decisions have held squarely that a RICO defendant need not have a supervisory position in order to violate section 1962(c)." (citations omitted)), cert. denied, 486 U.S. 1035 (1988).

different ways." H.J. Inc., 492 U.S. at 248-49. Accordingly, the RICO statute contains a direction to construe the statute's provisions liberally in order to effectuate the remedial purposes of the statute. 18 U.S.C. § 1961 note (84 Stat. 947).

Moreover, the Eighth Circuit's test appears to be inconsistent with this Court's dictum in H.J. Inc.. There, the plaintiffs alleged that the defendant, Northwestern Bell, had engaged in a pattern of bribing the members of the Minnesota Public Utilities Commission ("MPUC"). This Court stated that the plaintiffs, at trial, might be able to demonstrate a threat of continuity of racketeering activity by showing that the alleged bribes were Northwestern Bell's "regular way of conducting or participating in the conduct of the

alleged and ongoing RICO enterprise, MPUC."[16]

Significantly, the Court did not anticipate that the plaintiffs would need to prove that Northwestern Bell managed or operated the MPUC in some manner, and indeed, it seems unlikely that the plaintiffs in H.J. Inc. could ever meet that standard. Here, the level of participation that Arthur Young had in the conduct of the Co-op's financial affairs was at least as deep as the participation that Northwestern Bell allegedly had in the conduct of the MPUC's regulatory affairs.

Under the Eighth Circuit's view, almost any outsider to an enterprise can escape RICO liability. Yet the liability

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[16] H.J. Inc., 492 U.S. at 250.

of outsiders who participate in an enterprise's affairs is becoming an increasingly important issue in criminal and civil cases arising out of the failure of other financial institutions. Accountants and other outsiders who stray far beyond their appointed roles to originate frauds and injure investors should not be granted virtual immunity from RICO.

CONCLUSION

The Class therefore asks this Court to reject the Eighth's Circuit's test for the RICO "participation" element; announce a test that is consistent with the words and purposes of the RICO statute; reverse the grant of summary judgment against the Class' RICO claim;

and remand this action for further proceedings.

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

ARTHUR YOUNG & CO.,

Appellant,

v.

BOB REVES; ROBERT H. GIBBS; FRANCES GRAHAM,

Appellees.

THOMAS E. ROBERTSON, JR., As Trustee of the Farmer's Co-op of Arkansas and Oklahoma, Inc., and as representative of a class of members, depositors, and equity security holders, who are similarly situated to him; BOB REVES; FRANCES GRAHAM; ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS, and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds,

Appellants,

v.

ARTHUR YOUNG & CO.,

Appellee.

THOMAS E. ROBERTSON, JR., As Trustee of the Farmer's Co-op of Arkansas and Oklahoma, Inc., and as representative of a class of members, depositors, and equity security holders, who are similarly situated to him,

Appellees,

v.

ARTHUR YOUNG & CO.,

Appellant.

THOMAS E. ROBERTSON, JR., etc., et al.

v.

JACK WHITE, et al.

THOMAS E. ROBERTSON, JR., As Trustee of the Farmer's Co-op of Arkansas and Oklahoma, Inc., and as representative of a class of members, depositors, and equity security holders, who are similarly situated to him; BOB REVES; FRANCES GRAHAM; ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds,

Appellees,

v.

ARTHUR YOUNG & CO.,

Appellant.

THOMAS E. ROBERTSON, JR., etc., et al.

v.

JACK WHITE, et al.

ROBERT R. CLOAR, Class Counsel,

Appellant,

v.

BOB REVES,

Appellee.

Nos. 87-1726WA, 87-1727WA, 87-1083WA, 87-2533WA and 88-1014WA

Submitted March 12, 1991
Decided June 27, 1991

[Reported at 937 F.2d 1310]

Before FAGG and MAGILL, Circuit Judges, and SNEED,[1] Senior Circuit Judge.
MAGILL, Circuit Judge.

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[1] THE HONORABLE JOSEPH T. SNEED, Senior Judge, United States Court of Appeals for the Ninth Circuit, sitting by designation.

Arthur Young appeals from the district court's entry of judgment against it after a jury found that the firm had violated both federal and state securities laws.[2] On appeal, Arthur Young argues that the district court erred in (1) certifying the plaintiff class; (2) holding that the financial instruments at issue in this case were securities under Arkansas law; (3) denying its motion for judgment

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[2] This appeal is before us on remand after the Supreme Court reversed our earlier decision that the financial instruments at issue in this case were not federal securities. See Reves v. Ernst & Young, 494 U.S. 56, 110 S.Ct. 945, 108 L.Ed.2d 47 (1990), rev'g Arthur Young & Co. v. Reves, 856 F.2d 52 (8th Cir. 1990). We had ruled that the instruments were not federal securities under the test from SEC v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946). See 856 F.2d at 55. The Supreme Court, however, declined to apply the Howey test, and instead applied the Second Circuit's "family resemblance" test, see, e.g., Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976), to conclude that the instruments were securities under federal law. 110 S.Ct. at 952.

notwithstanding the verdict on the state and federal securities claims; and (4) denying its motion for a new trial on the ground that a requested instruction on contribution was not given to the jury. Arthur Young also argues that the damages awarded to the appellees were not supported by the evidence and challenges the district court's awards of attorney fees, costs, and interest to the appellees. On cross-appeal, Reves and Robertson challenge a number of the district court's rulings, including its dismissal of Robertson's breach of contract claim, its granting of summary judgment in favor of Arthur Young on Reves' RICO claim, its crediting of settlement proceeds against the jury's verdict, and its decision on fees for Reves' counsel. We affirm in part and reverse in part.

I.

A. The Co-op

The facts of this case involve the Farmer's Cooperative of Arkansas and Oklahoma, Inc. (Co-op), which was organized in 1946 and operated in western Arkansas and eastern Oklahoma. Any farmer in the area could become a member, and as a member was entitled to one share and one vote. Each year the Co-op's members elected twelve of their own to serve on a Board of Directors. The Board met monthly to review the Co-op's operations, but delegated actual management of the Co-op to a general manager, whom the Board appointed. In 1952, the Board named Jack White as general manager. White served in that capacity until the Board removed him in mid-1982.

To raise money for its operating expenses, the Co-op sold promissory notes payable to the holder on demand. These

demand notes, while uncollateralized and uninsured, were nonetheless attractive to investors because they paid a higher interest rate than that local financial institutions offered. The Co-op advertised the demand note program in its monthly newsletter as an "Investment Program." The advertisement stated the rate of interest the notes would earn and claimed: "YOUR CO-OP has more than $11,000,000 in assets to stand behind your investments. The Investment is not Federal [sic] Insured but it is . . . Safe . . . Secure . . . and available when you need it. Interest is computed to the day of withdrawal." See, e.g., Joint Appendix (JA) at 1820 (ellipses in original).

B. The Gasohol Plant

In 1979, the Co-op's general manager, White, joined with entrepreneur Edwin Dooley to finance and construct a gasohol plant. Dooley and White each invested $125,000 of their own funds and as a result each owned half of the enterprise, which was known as Big D & W Refining and Solvents, Inc. Dooley served as president of the corporation; White was its secretary. Construction of the plant began in June 1979. Four months later, White, financed by a loan from the Citizens Bank & Trust Company (Citizens Bank), purchased Dooley's interest in Big D & W and renamed the company White Flame Fuels, Inc. (White Flame).

Beginning in January 1980, White obtained loans from the Co-op to finance the continued construction and the initial operation of the gasohol plant. White

personally guaranteed these loans. The plant finally began producing gasohol the following April, but was soon beset by problems stemming from the plant's poor design and outside economic factors. White continued to obtain loans from the Co-op; by December 1980, these loans totalled approximately $4 million.

In September 1980, White was indicted for federal tax fraud. The indictment charges, among other things, that White had engaged in a course of self-dealing with the Co-op and had filed fraudulent tax returns. Also indicted with White was Gene Kuykendall, the Co-op's longtime accountant, who was also White Flame's accountant at this time.

Shortly after the indictment, at a November 12, 1980, Board meeting, White proposed that the Co-op purchase White Flame. The Board agreed and voted to

acquire the company. One month later, however, the Co-op filed a declaratory action against White and White Flame in state court. The complaint had been drafted by White's attorneys, and alleged that on February 15, 1980, White had told the Board that all of White Flame's stock would be transferred to the Co-op in exchange for the Co-op's assumption of White's debts to the Co-op and Citizens Bank.[3] The complaint alleged that in reliance on this agreement, the Co-op invested further sums in White Flame, based on the assumption that it owned the company. The complaint next alleged that White did not transfer the stock as agreed,

[3] The minutes of the Co-op Board Meeting for February 15, 1980, do not contain any references to the Co-op acquiring the stock of White Flame. JA at 933. In fact, the first reference to the Co-op purchasing White Flames does not occur until the minutes of the November 12, 1980, Board meeting. JA at 1070.

and that the Co-op had not executed a note assuming White's debts to Citizens Bank. Based on these allegations, the Co-op sought a declaratory judgment stating that the Co-op had acquired White Flame on or about February 15, 1980; that the Co-op had assumed Jack White's debt to Citizen's Bank; that all amounts to the Co-op lent to Jack White or White Flame before February 15, 1980, were investments in White Flame; and that Jack White was discharged from any debts to the Co-op relating to White Flame.

Shortly after the complaint was filed, White's attorneys sent the Co-op's attorney, Carl Creekmore, White's answer and a proposed consent decree. Creekmore filed the answer and obtained the state court's approval of the decree on December 19; but the decree was not filed until January 26, 1981. The decree

provided that the Co-op had owned White Flame since February 15, 1980; that the Co-op had assumed White's debt to Citizen's Bank; and that White was discharged from any liability to the Co-op for loans for White Flame. The result of this friendly suit was that White was relieved of over $4 million of debt and that the Co-op owned White Flame as of February 15, 1980.

C. The 1981 Audit

Both White and Kuykendall were convicted of tax fraud in January 1981.[4]

[4] This court affirmed these convictions in United States v. White, 671 F.2d 1126 (8th Cir. 1982). The evidence in the criminal case showed that White had engaged in a course of self-dealing with the Co-op, and that he and Kuykendall had cooked the Co-op books and filed fraudulent tax returns to cover up White's activities. We concluded: "The record cleary demonstrates that White and Kuykendall manipulated the Co-op's finances to serve their own personal ends, and that they distorted the Co-op's records of receipts. . . ." Id. at 1134.

Testifying on White's behalf at the criminal trial was Harry Erwin, the managing partner of Russell Brown and Company, Arkansas' largest accounting firm at that time.[5] Shortly after White's conviction, his lawyer contacted a member of Russell Brown and stated that the Co-op was interested in hiring the firm. In June 1981, Jack White and Kirit Goradia, the Co-op's office manager, met with Erwin and Joe Drozal, another member of Russell Brown. Later that year the Co-op hired Russell Brown to perform the Co-op's 1981 audit. Joe Drozal was named the partner in

[5] On January 2, 1982, Russell Brown merged with Arthur Young and Company. After the merger, Erwin was placed in charge of Arthur Young's Arkansas practice. Later, Arthur Young and Company became Ernst & Young. For the sake of consistency with the earlier opinions in this case, future references will be to "Arthur Young."

charge; Joe Cabaniss was selected to assist him.

After beginning the 1981 audit process in early 1982, Drozal became aware that there were problems concerning how White Flame should be treated for accounting purposes. In a January 26, 1982,[6] memo, Drozal raised several problems relating to the valuation and acquisition of White Flame. He observed that White Flame's records contained no detailed documentation of cost or expense allocations. Drozal also specifically noted that the Co-op's audited financial statement for 1980 had disclosed the Co-op's full ownership of White Flame, but had not disclosed that the Co-op had forgiven

[6] Russell Brown had merged with Arthur Young by this time. See supra note 4.

the $4 million in loans White had personally guaranteed. JA at 1189-1191.

One of Drozal's first tasks in the audit was to determine White Flame's fixed asset value. Drozal realized that he could not rely on the fixed asset value provided for White Flame in the 1980 financial statement because Kuykendall, a convicted felon, had prepared that statement. Therefore, Drozal had to determine it on his own. One way of determining fixed asset value is to add the asset's construction costs to its capitalized expenses. Drozal knew there was a problem with White Flame's reported capitalized expenses, because Jack White had told him that because the plant was only producing at 20% of capacity, they had included only 20% of their production costs as expenses; the remaining 80% of the production costs were added to the fixed asset value of the

plant. Drozal's superior at Arthur Young informed him that only those costs should be added to the plant's value. JA at 1215; 9 Tr. at 236. Drozal's investigation into the treatment of the production costs was limited mainly to talking with Jack White, and reviewing the construction costs and capitalized expenses reported in White Flame's books, which Drozal knew that Kuykendall had prepared. 9 Tr. at 186.[7] Drozal concluded, based primarily on information provided by convicted felons, that the plant's value at the end of 1980 was $4,393,242.66, exactly the same figure Kuykendall had calculated. JA at 1219. Using this figure as a base, Drozal factored in the 1981 construction costs and

[7] Kuykendall testified that he fabricated these numbers on White's direction and attempted to cover up the scheme by slightly varying the percentages of costs expensed. 7 Tr. at 258.

capitalized expenses, and concluded that White Flame's 1981 fixed asset value was approximately $4.5 million. Id.

Once Drozal determined White Flame's fixed asset value, he had to determine how that value should be treated for accounting purposes. This involved examining the circumstances of the Co-op's acquisition of White Flame. If the Co-op had owned White Flame from the beginning of construction in 1979, White Flame's value for accounting purposes would be its fixed asset value, $4.5 million. If the Co-op had purchased White Flame from Jack White, however, then White Flame's value for accounting purposes would be its fair market value at the time of purchase. Moreover, if the Co-op had purchased White Flame from White, the transaction would have to be closely scrutinized, because White was an officer of the Co-op. Drozal

concluded that the Co-op had owned White Flame from the beginning, and thus that the plant should be valued at $4.5 million. He based this conclusion on the Co-op's having lent White funds for the plant's construction and operation; that White was supervising the construction and operation; and that the court decree stated that all of the Co-op's loans to White had been investments in the plant. 9 Tr. at 224. Drozal believed that characterizing White Flame as having always been owned by the Co-op reflected "economic reality." Id.

In concluding that the Co-op had always owned White Flame, Drozal ignored a great deal of information suggesting exactly the opposite. For example, although he relied on the court decree's statement that the Co-op's loans to White were really investments, Drozal ignored that part of the decree that stated that

the Co-op had acquired White Flame on February 15, 1980. He ignored the facts that White Flame's tax returns indicated that it was owned by Jack White and Edwin Dooley; that each had initially invested $125,000 in White Flame; that White had eventually bought Dooley out; that White had always personally guaranteed the loans he received from the Co-op; and that the Co-op's 1979 audit contained no mention of White Flame. Drozal never talked with Dooley, with any 1979 or 1980 Board members, with the Co-op's lawyer, or with the Co-op's previous auditor.

By concluding that the Co-op had always owned White Flame, Drozal was able to avoid applying auditing standards that required a closer look at the actual acquisition and was also able to avoid having to value the plant at its fair market value. The advantage of reaching

this conclusion was clear: Drozal knew that if White Flame were valued at less than $1.5 million, the Co-op's net worth for 1981 would have been wiped out. 10 Tr. at 41.[8] Drozal also knew that bad news about the Co-op's financial condition could provoke a run on the demand notes and thus deprive the Co-op of its primary source of funds. 9 Tr. at 189.

D. The 1981 Audit Report to the Board

On April 22, 1982, Arthur Young[9] presented its 1981 audit report to the Co-

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[8] One expert witness testified at trial that as of December 31, 1981, White Flame was not economically viable, and that its liquidation value was $500,000 to $700,000. 4 Tr. at 97. Another expert, who used a more sophisticated appraisal method, testified that White Flame's fair market value at the end of 1981 was between $444,000 and $1.5 million. 4 Tr. at 184. Arthur Young did not attempt to rebut this testimony.

[9] See supra note 4.

op's Board of Directors. Arthur Young concluded that with two exceptions, the Co-op's consolidated financial statements fairly presented the Co-op's financial position. The relevant exception stated that Arthur Young had "some doubt as to the recoverability of the investment in the gasohol plant of White Flame Fuels, Inc. and its continuing operations," JA at 235. The firm explained: "Management has not prepared projections and other analyses to assess the potential recovery of this investment. Accordingly, we are unable to satisfy ourselves as to the appropriate carrying value of such amounts as presented in the accompanying consolidated factual statements." Id.

The financial statements attached to the audit report listed the Co-op's assets at $20,869,300. Included in this total was $4,522,086 for the gasohol plant.

The Co-op's liabilities totaled $18,246,743, including $12,164,007 in unredeemed patron demand notes. The Co-op's net worth was $2,622,557. The financial statement's Note 9 addressed White Flame. The note stated, in relevant part:

> Financing of the initial construction and subsequent revisions which totaled approximately $4,522,000, was provided by the Co-op. Also, from the initial start of production through December 31, 1981, the Co-op has provided operating capital for White Flame. As of December 31, 1981, the Co-op had an investment of approximately $5,830,000 in White Flame. The ability of the Co-op to continue providing funds to cover the operating losses of White Flame Fuels, Inc. (currently averaging $100,000 per month) until such time that improvements in market conditions and production efficiency permit profitable operations are not determinable. The combination of factors as mentioned above, which must result favorably, cast doubt on the recovery by the Co-op of its investments in White Flame Fuels, Inc. and the recovery by White Flame Fuels, Inc. of its investment in plant and equipment on the basis of

> a going concern. Projections and other analyses have not been prepared by management in order to assess the potential recoverability of this investment.

JA at 251-52.

Arthur Young did not tell the Board that it concluded that the Co-op had always owned White Flame and thus was able to value the plant at $4.5 million. 9 Tr. at 227. Nor did it tell the Board that if the Co-op had purchased White Flame, as opposed to owning it from the beginning, there might be a net worth problem. Moreover, Arthur Young never specifically asked the Board or the Co-op's management for projections as to the operations of White Flame. 10 Tr. at 57-58.

E. The 1982 Annual Meeting

On May 27, 1982, the Co-op held its annual meeting. Approximately 350 people attended. At the meeting, the Co-

op distributed condensed financial statements that purported to convey the economic health of the organization.[10] The condensed financial statement for 1981 stated that the Co-op's assets were $20,869,300 and that its liabilities were $18,246,743, leaving the Co-op with a net worth of $2,622,557. JA at 1231. The statement included White Flame's $4.5 million asset value in its total assets, but did not include White Flame's $1.2 million loss. The statement also failed to include any of the information about White Flame's status found in Note 9 of the audit report.

The condensed financial statement also contained the annual meeting's agenda. Listed as giving the financial report was

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[10] The Co-op prepared these statements based on Arthur Young's audit report and the accompanying financial statement.

"Harry C. Erwin, C.P.A., ARTHUR YOUNG & COMPANY." JA at 1241. Also present from Arthur Young was Joe Cabaniss. Erwin received the two condensed financial statements when he arrived at the meeting. He had no advance preparation as to the statement's contents. As he began his presentation, Erwin informed the members that they had condensed statements and that copies of the full audit were at the Co-op's offices. Erwin then started to discuss the condensed statement. The audience soon began asking questions about the acquisition of White Flame and its financial status. When asked how much money White Flame had lost, Erwin responded that it was a separate corporation under federal law. Erwin was also asked how the Co-op had acquired White Flame and responded that he though the Board had voted to acquire it. During these

interchanges, White Flame's $1.2 million loss was disclosed to the audience. The meeting began to get very heated, with the audience asking many questions about White Flame and other items in the condensed statement. As the questions increased in both frequency and intensity, Erwin was unable to respond and the Board moved the meeting on.

The result of Erwin's five-minute presentation was that the audience knew that the Co-op owned White Flame and that the plant had $1.2 million in losses. However, Erwin did not disclose the following: Arthur Young's conclusion that the Co-op had always owned White Flame; that as a result of this conclusion White Flame was valued at $4.5 million; the material in Note 9 of the full financial statement; that Arthur Young had qualified its audit opinion; that Arthur Young could

not satisfy itself as to the proper carrying value of White Flame; or that a write-down of White Flame to its fair market value would wipe out the Co-op's net worth. 12 Tr. at 112-13.

F. The 1982 Audit

The Co-op also hired Arthur Young to perform the 1982 audit. Erwin and Drozal were again Arthur Young's point men. Joe Cabaniss was again selected to work with Drozal and prepared a background memo on the 1982 audit. JA at 1234. The memo classified the Co-op as a "close monitoring client," i.e., a client that might pose some type of risk to Arthur Young. The memo also addressed issues of particular importance for the Co-op's audit. These included the recoverability of the gasohol plant and the condensed financial statements for 1981. As regards the

gasohol plant, Cabaniss, before talking to Drozal, believed its acquisition involved a related party transaction, and hence that the Co-op had not always owned it. Cabaniss also expressed his doubts as to whether the gasohol plant could ever make money. As regards the condensed financial statements, Cabaniss noted:

> At the annual meeting the patrons are provided with condensed financial statements. Last year they were given a consolidated balance sheet and a Co-op only income statement which did not reflect the equity in the earnings (loss) of White Flame. We should advise the client of this misleading presentation and find an acceptable manner of presentation.

JA at 1240.

Arthur Young proceeded with the audit. Standard auditing procedures require the auditor to obtain a client representation letter. This letter, drafted by the auditor, but signed by the client's chief executive and financial

officers, states that the client's financial records are accurate and consistent with generally accepted accounting principles. The Co-op's letter for the 1982 audit was signed by Fred Howard, who had replaced Jack White as the Co-op's General Manager. Kirit Goradia, the Co-op's office manager, who essentially functioned as its chief financial officer, did not sign the letter. In the space provided for signing one's name, Goradia wrote: "My only response is attached herewith not as part of this letter." JA at 1245. The attachment stated: "This is to state that during the course of your 1982 audit of books and records of [the Co-op and White Flame], I have not intentionally withheld any information from you." JA at 1246. Goradia told Cabaniss that he did not want to sign the letter because if something happened later, he did

not to be accused of wrongdoing. 11 Tr. at 140. Normally, when a company's chief financial officer refuses to sign a representation letter, the auditor is supposed to disclaim the audit opinion or issue an adverse opinion. Id. at 142. Arthur Young, however, did not believe that Goradia had refused to sign the letter, and thus did neither.[11]

G. The 1982 Audit Report to the Board

Arthur Young presented its 1982 audit report to the Board on March 7, 1983. The 1982 report was substantially similar to the 1981 report. Arthur Young again stated that "there is some doubt as to the

[11] Arthur Young did not get a signed client representation letter for the 1981 Co-op audit either. When asked about this at trial, Cabaniss responded: "Now, the year before, we thought we had that sucker, and . . . we believed we had it. There was no reason to even think it had been refused." 11 Tr. at 142.

recovery of the investment in [White Flame] and its continuing operation. Management has not prepared projections and other analyses to assess the potential recovery of this investment." JA at 258. Arthur Young again concluded: "Accordingly, we are unable to satisfy ourselves as to the appropriate carrying value of such amounts as presented in the accompanying consolidated financial statement." Id. Arthur Young's concerns were more fully explained in Note 8 to the financial statement, which was basically the same as the 1981 audit report's Note 9.

The 1982 financial statement reported that the Co-op had assets of $17,127,986 and liabilities of $15,741,240, resulting in a net worth of $1,386,746. The gasohol plant was listed as an asset worth $4,537,520.

H. The 1983 Annual Meeting

The Co-op's 1983 annual meeting was held on March 24 of that year. Sometime before the meeting Goradia and Cabaniss discussed the Co-op's condensed financial statements. Cabaniss told him that Arthur Young's name should not be on the condensed statement because the statement would be misleading without the explanatory notes. Shortly before the meeting Cabaniss and Drozal received a copy of the condensed statement, which stated in boldface letters across the top of the page: "The following financial information was condensed from Arthur Young & Company's Annual Audit." JA at 1248. Drozal and Cabaniss saw that Arthur Young's name was on the statement and that Note 8 was omitted, but said nothing to Goradia. 11 Tr. at 149.

The annual meeting's program stated that the financial report would be given by Arthur Young. Cabaniss began the financial report by informing the audience that they possessed condensed statements, and that full audit reports were at the Co-op's offices. He knew as he began that the condensed statement was misleading because it did not contain the explanatory notes to the audit. Id. at 150. The presentation lasted three minutes. Cabaniss did not tell the audience that the report was misleading. He did not tell them about Note 8, that Arthur Young was unable to satisfy itself as to White Flame's value, or that if White Flame was written down to its fair market value the Co-op might be in financial trouble. At that time, White Flame's stated value after depreciation was approximately $3.5 million. The Co-op's net worth was $1.3

million. If the plant has been written down to less than \$2.2 million, the Co-op's net worth would have been wiped out.[12]

I. Bankruptcy

The demand note program was not the Co-op's only source of funds. It also received loans and lines of credit from the Cooperative Finance Association (CFA), which was owned by Farmland, a regional supply cooperative. William Moon, a vice-president of CFA, had informed the Co-op that because of its reliance on demand notes, if the amount of invested notes dropped below \$9.5 million, CFA would cut off the Co-op's line of credit. In the fall of 1983, CFA advanced the Co-op a \$5.78 million line of credit to finance its grain inventory and operations. 3 Tr. at

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[12] See supra note 5 for the experts' appraisals of White Flame's value.

46. In February of 1984, representatives of the Co-op met with CFA to arrange more financing. 12 Tr. at 12. Later that month the Co-op had a slight run on the demand notes. Id. The Co-op asked CFA for the money on its line of credit to protect itself from further runs. Id. CFA, because total demand note investments had dropped below \$9.5 million, decided not to advance the Co-op any of the \$800,000 the Co-op had remaining on its line of credit. 3 Tr. at 161. The Co-op then filed bankruptcy proceedings on February 23, 1984, to protect itself from a run on the demand notes. 12 Tr. at 13. In the subsequent bankruptcy disclosure statement, which the bankruptcy court approved on September 4, 1984, the Co-op asserted that three factors caused its bankruptcy: (1) ineffective management; (2) using demand notes as the primary source of

financing; and (3) the financial problems of White Flame. AY Ex. 223. The result of the bankruptcy filing was that the demand notes were frozen in the bankruptcy estate, and thus were no longer redeemable at will by the noteholders.

J. Trial

After the Co-op filed for bankruptcy, it remained as debtor in possession until October of that year, when the bankruptcy court appointed Thomas Robertson as trustee. On February 14, 1985, Robertson, on behalf of the Co-op and certain demand noteholders, filed suit against forty individuals and entities, including members of the Co-op's Board, the Co-op's lawyers, Jack White, Kirit Goradia, Gene Kuykendall, and Arthur Young. On September 27, 1985, the district court certified a class of noteholders consisting

of people who purchased demand notes between February 15, 1980, and February 23, 1984, naming Bob Reves, Frances Graham, and Robert Gibbs the class representatives.[13] Robertson thus no longer represented the Class, but only the Co-op. Before trial, Robertson and the Class settled with all defendants except Arthur Young and Jack White's legal representatives.[14]

Robertson and the Class asserted seven claims against Arthur Young. Four of these claims are relevant to this appeal: (1) Robertson's claim that Arthur Young breached its auditing contract with the Co-op because the firm did not perform its audits in accordance with generally accepted accounting principles and auditing

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[13] Future references to the noteholders will be to the "Class."

[14] Subsequent to trial, Robertson and the Class settled with White's lawyers as well.

standards; (2) the Class' claim that Arthur Young induced the purchase of demand notes through the concealment of the Co-op's financial position in violation of 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5; (3) the Class' claim that Arthur YOung induced the purchase of demand notes through the concealment of the Co-op's financial position in violation of Arkansas securities law; and (4) Robertson's and the Class' claim that Arthur Young was a material participant in the operation and management of the Co-op, in violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-68. Arthur Young then cross-claimed against the Co-op's Board of Directors seeking contribution.

Before trial, the district court dismissed Robertson's action for securities fraud and Robertson's and the Class' breach

of contract claim. See Robertson v. White (Robertson I), 633 F. Supp. 954, 974, 976 (W.D. Ark. 1986). The district court also determined before trial that the demand notes were securities under both federal and Arkansas law. See Robertson v. White (Robertson, II), 635 F. Supp. 851, 865 (W.D. Ark. 1986). Arthur Young then moved for summary judgment on Robertson's and the Class' RICO claim, which the district court granted. See Robertson v. White (Robertson III), Nos. 85-2044, 85-2096, 85-2155, 85-2259, slip op. at 116 (W.D. Ark. Oct. 15, 1986).

Trial commenced on October 22, 1986, and lasted approximately a month. Robertson's and the Class' witnesses consisted mainly of Board members, accounting, legal, and appraisal experts, and Arthur Young personnel. Arthur Young's witnesses consisted mainly of Board

members, a legal expert, and two state court clerks.[15] After trial, the jury found that Arthur Young had committed both state and federal securities fraud.[16]

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[15] While reviewing the trial transcript after oral argument, we noticed that Board member Larry Heatherington, who was not listed in the transcript's table of contents, did testify. See 2 Tr. at 201-40. We also noticed that at least one part of the trial was not transcribed, namely, the closing argument of counsel for Jack White's law firm. See 16 Tr. at 130-33. Because of our concern with the integrity of the transcript, we requested counsel for Arthur Young and the Class to provide us with a list of the witnesses who testified. Robertson's list, which Arthur Young agreed was accurate, does not include Heatherington. We can only conclude that both parties relied on the transcript's various tables of contents. As a result, we still have reservations about the trial transcript's accuracy. Because apparently neither of the parties share our reservations, we will treat it as accurate.

[16] Although not relevant to the issues on appeal, we note that the jury also found that Arthur Young negligently performed the Co-op's 1981 and 1982 audits, that the Co-op was contributorily negligent, and that Arthur Young had not committed common-law fraud in its performance of those audits.

The jury found that the Class' damages as a result of the fraud totaled $6,121,652.94.

After the jury returned the verdict, the district court asked the parties to make all motions that might affect the judgment. Responding to these motions in a post-trial memorandum, the district court decided that sums the Class had already received as a result of settlements should offset the jury's verdict. See Robertson v. White (Robertson IV), Nos. 85-2044, 85-2096, 85-2155, 85-2259, slip op. at 37 (W.D. Ark. Feb. 5, 1987). The district court also denied Arthur Young's motions for judgment notwithstanding the verdict (JNOV) on the state and federal securities claims. Id. at 49, 61. Finally, the district court rejected Arthur Young's argument that the

court wrongly denied the firm's contribution claim. Id. at 54.

The district court's final judgment as regards Arthur Young was as follows:

> Arthur Young is ordered to pay to the Class $6,121,652.94, plus prejudgment interest, attorney fees (only on the state securities claim) and costs, under both state and federal claims, subject to a credit in the amount of $5,774,780, conditional on settlements with the Class being approved. The judgment shall bear prejudgment interest and carry an award of fees under the state act, and prejudgment interest under the federal securities law claims. Questions relating to the eligibility for fees under the federal claim, and the amount of any fees, shall be later determined. The court shall set a schedule for plaintiffs to file a bill of costs and a petition to establish the amount of prejudgment interest and fees due. The Class shall be allowed the larger net recovery under this Count, after allowing credits and determining fees, interest and costs.

Amended Judgment Order, Nos. 85-2044, 85-2096, 85-2155, 85-2259 (W.D. Ark. Apr.

23, 1987). Arthur Young, the Class, and Robertson appealed the various judgments, rulings and orders.

K. Subsequent History

This case first came before us in 1988. See Arthur Young & Co. v. Reves, 856 F.2d 52 (8th Cir. 1988). At that time we reversed the district court's judgment on the threshold issue of whether the demand notes were securities under the federal or Arkansas law, holding that they were not. See id. at 55. Subsequently, the Supreme Court vacated our opinion and reversed, holding that the notes were securities within the meaning of § 3(a)(10) of the Securities Act of 1934, codified at 15 U.S.C. § 78c(a)(10) (1988). See Reves v. Ernst & Young, 494 U.S. 56, 110 S.Ct. 945, 953, 108 L.Ed.2d 47 (1990). On remand, we

now address the plethora of issues the parties originally raised on appeal.

II.

A. Class Certification

[Text Omitted]

B. Robertson's Breach of Contract Claim

[Text Omitted]

C. The RICO Claim

[4] The Class argues that the district court improperly granted summary judgment in favor of Arthur Young on its RICO claim. The Class alleged in its complaint that Erwin, Drozal, and Cabaniss conducted or participated in the affairs of the Co-op, committing both mail fraud and securities fraud, in violation of 18 U.S.C. § 1962(c), which provides: "It shall be unlawful for any person employed

by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity. . . ."

Summary judgment is proper where, viewing the evidence in the light most favorable to the nonmoving party, and giving that party the benefit of all reasonable inferences to be drawn from that evidence, the movant is entitled to judgment as a matter of law. See Agristor Leasing v. Farrow, 826 F.2d 732, 734 (8th Cir. 1987). Viewing the evidence in the light most favorable to the Class, we agree with the district court that, as a matter of law, Arthur Young's involvement with the Co-op did not rise to the level required for a RICO violation. In Bennett v. Berg,

710 F.2d 1361 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008, 104 S.Ct. 527, 78 L.Ed.2d 710 (1983), we addressed the nature of the participation required of a RICO defendant before liability is appropriate: "A defendant's participation must be in the conduct of the affairs of a RICO enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." Id. at 1364. Arthur Young's involvement with the Co-op was limited to the audits, meetings with the Board of Directors to explain the audits, and presentations at the annual meetings. In the course of this involvement it is clear that Arthur Young committed a number of reprehensible acts, but these acts in no way rise to the level of participation in the management or operation of the Co-op.

The Class contends that we should follow the Eleventh Circuit's decision in Bank of Am. Nat'l Trust & Sav. Ass'n v. Touche Ross & Co., 782 F.2d 966 (11th Cir. 1986), where that court stated that it "is not necessary that a RICO defendant participate in the management or operation of the enterprise." Id. at 970. We are aware of the inconsistencies between the circuits regarding the necessary level of participation for RICO liability. See Yellow Bus Lines v. Drivers, Chauffeurs & Helpers Local Union 639, 913 F.2d 948, 952-55 (D.C. Cir. 1990) (en banc) (reviewing the varied approaches to the participation requirement taken by the Second, Fourth, Fifth, Seventh, Eighth and Eleventh Circuits and adopting the Eighth Circuit's standard), cert. denied, ____ U.S. ____, 111 S.Ct. 2839, 115 L.Ed.2d 1007 (U.S. June 17, 1991). But until the

Supreme Court rejects our standard or this court en banc overrules Bennett, we are bound to follow that decision. Therefore, we conclude that the district court properly granted summary judgment in favor of Arthur Young on the Class' RICO claim.

D. Demand Notes and Arkansas Law

[Text Omitted]

E. The State Securities Fraud Claim

[Text Omitted]

F. The Rule 10b-5 Claim

[Text Omitted]

H. The Damages

[Text Omitted]

I. The Settlement Credit

[Text Omitted]

J. Conclusion

[Text Omitted]

III.

A. Interest

[Text Omitted]

B. Costs

[Text Omitted]

C. Fees

[Text Omitted]

D. Class Counsel

[Text Omitted]

E. Conclusion

[Text Omitted]

IV.

[Text Omitted]

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as Trustee of the Farmer's Co-op of Arkansas & Oklahoma, Inc.; BOB REVES; FRANCES GRAHAM, ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds,

Plaintiffs,

v.

JACK E. WHITE, ET AL.,

Defendants.

Consolidated Cases No. 85-2044, 85-2096, 85-2155, 85-2259
H. Franklin Waters, Chief Judge

MEMORANDUM OPINION
FILED OCTOBER 15, 1986

I. INTRODUCTION

In Robertson v. White, 633 F.Supp. 954 (W.D. Ark. 1986) we tested the legal sufficiency of the plaintiffs' consolidated complaint. We tried to make it clear at

that time that our purpose was to determine which allegations could sustain a cause of action under the most liberal and indulgent construction. Even so, the court was greatly troubled by certain of the plaintiff's claims. We suggested that some of them may very well have been barred by the statutes of limitations. Instead of dismissing them at that point, we advised the parties that we would rule on the questions later, in connection with motions for summary judgment. In addition, we expressed reservations about the applicability of certain causes of action to the parties. In this connection, we were doubtful that R.I.C.O. questions could be raised against the work of auditors, based on dicta in Bennett v. Berg 710 F.2d 1361 (8th Cir. 1983). The passage of time has brought with it two recent Eighth Circuit civil R.I.C.O. decisions which

raised for our consideration vexing questions whether any of the defendants had been shown to have operated an enterprise "through a pattern" of racketeering activity. See, Fulmer v. Superior Oil Co., 785 F.2d 252 (8th Cir. 1986) and Holmberg v. Morrissette, Civ. 85-5138 (8th Cir., slip op., Sept. 3, 1986). That the court of appeals for our circuit would overturn two verdicts, the factual findings of which are to be deemed controlling unless "clearly erroneous" FRCP, Rule 52(b), indicates to us that the court to whom we are immediately responsible has developed and is developing a requirement for pattern fundamentally more rigorous than one which it suggested might be appropriate in Alexander Grant v. Tiffany Industries, 770 F.2d 717, 718 n.1 (8th Cir., 1985). Those who thirst for consistency in the law can find their solace in the fact that

Alexander Grant explicitly said that it was not passing on the sufficiency of a showing of pattern in its decision, was judging (as we did) only the sufficiency of a pleading, and, coming a year before Fulmer and Holmberg, can hardly be said to be the final word on the topic. It may be possible that our system of notice pleading will permit still more R.I.C.O. cases to enter discovery, since "pattern", unlike fraud, may not have to be specifically pleaded. It is probable, therefore, that cases under a Rule 12 examination will continue to confuse the resolution of motions arising under Rule 56. The sufficiency of the plaintiffs' case is here today subjected to a more rigorous screening than the one which we pursued a half a year ago. In that connection, too, the rules for decision have changed. Whereas formerly the Eighth Circuit

enjoined that motions under Rule 56 be denied if even the "slightest doubt" was present, Traylor v. Black, Sivalls, and Bryson, 189 F.2d 213 (8th Cir., 1951); now the trial courts are admonished to enter judgment against parties where no reasonable jury could find for them on the best construction of facts submitted in support of their case. Anderson v. Liberty Lobby, Inc., 54 U.S.L.W. 4755 (June 23, 1986). We do not sit as triers of fact, and make no credibility determinations, since under our Constitution, that lies with the province of the jury. U.S. Const., Amendment 7. Rather, we determine whether, for example, the plaintiffs' evidence, if believed, suffices, to present a factual question subject to resolution by a jury. If not, we enter judgment for the moving party, as we did for plaintiffs on their securities law claims a few months

earlier. Robertson v. White, 635 F. Supp. 851 (W.D. Ark. 1986).

If it appears to the professional reader that the court is writing far too pedantically, we plead guilty and offer by way of explanation our hope that members of the press, who will read this opinion and broadcast its holdings extensively in the week before trial commences, will take special pains to inform its audience that the court is making no factual findings in this opinion, only deciding whether plaintiffs should be allowed to present all or part of their case to a jury. Parties on all sides of the case have remarked that an extraordinary amount of press coverage seems to have developed out of this lawsuit. This is understandable in a case involving 23,000 plaintiffs and nearly 40 defendants. Defendant Creekmore is a well-known member of the community, having

served as a circuit judge for several counties in this federal division for 20 years. Other of the defendants are professional accountants and lawyers with fine reputations in the community. The court is therefore concerned that persons reading this opinion not "misreport" the court's legal conclusions to the public. The plaintiffs have made a number of allegations against the defendants. This opinion finds that some of them may not be presented to a jury, and that others can be. That is all. The sole aim of this opinion is to determine whether a juror, if he believed the plaintiffs' evidence and the most reasonably favorable interpretation of it, could decide the case adversely to defendants. It goes without saying that no juror is bound to hold against them because of anything we say or do here. The court is very concerned that

the press exercise extreme care in advising the public of the very limited nature of our inquiry, so that no needless prejudice will attend the parties' quest to draw a fair-minded jury from the seven counties in our federal division. We believe that the press has done a good job in this respect, and will continue to do so throughout the remainder of these proceedings. We would feel very uneasy, this close to trial, to release these opinions without appropriate cautions. With this in mind, we will proceed to examine the record on defendants' motions for summary judgment under Rule 56 of the Federal Rules of Civil Procedure.

II. COUNT I: RETURN OF FEES PAID BY THE CO-OP

[Text omitted].

III. COUNT II: FRAUD, NEGLIGENCE, AND CONSPIRACY IN TRANSFER OF GASOHOL PLANT

[Text omitted].

IV. COUNT III: SECURITIES FRAUD IN TRANSFERRING WHITE FLAME STOCK TO THE CO-OP

[Text omitted].

V. COUNT IV: NEGLIGENCE AND FRAUD IN ALLOWING THE CO-OP TO CONTINUE IN OPERATION AFTER INSOLVENCY

[Text omitted].

VI. COUNT VI: ACTIONS UNDER STATE AND FEDERAL SECURITIES LAWS CLAIMS

[Text omitted].

VII. COUNT XII: RICO ACTIONS AGAINST THE LAWYERS AND ACCOUNTANTS

Defendants' legal objections to plaintiffs' RICO causes of action are twofold: first, that plaintiffs cannot prove that the lawyers and accountants participated in the management or control of the Co-Op, Bennett v. Berg, 710 F.2d 1361, 364 (8th Cir. 1983) (en banc); second, that plaintiffs cannot prove that

the lawyers and accountants managed any enterprise "through a pattern" of racketeering activity. Holmberg v. Morrissette, No. 85-5138 (8th Cir., slip op. Sept. 3, 1986); Superior Oil Co. v. Fulmer, 785 F.2d 252 (8th Cir., 1986).

To the extent that plaintiffs base their case against Arthur Young and Co. on allegations that it participated in the operation or management of the Farmers' Co-Op, they must fail. Plaintiffs have compiled an extensive record; yet, from it they are able to show just five acts by Arthur Young which they suggest support a finding of control: (a) the accountants allegedly created the Co-op's financial statements; (b) the accountants failed to obtain client representation letters; (c) they addressed shareholder meetings; (d) they participated in the creation of condensed financial statements; and (e) the

accountants helped the Co-op handle certain matters with government agencies. Perhaps the court misunderstands plaintiffs' theories in this regard, but these activities hardly bespeak the kind of "operation and management" with which we understand Bennett v. Berg, Ibid., to be concerned. Plaintiffs have failed to show anything more than that the accountants reviewed a series of completed transactions, and certified the Co-op's records as fairly portraying its financial status as of a date three or four months preceeding the meetings of the directors and the shareholders at which they presented their reports. We do not hesitate to declare that such activities fail to satisfy the degree of management required by Bennett v. Berg, Id.

Conceding that the question of "control" is closer with respect to the

lawyers Ball and Mourton, and Carl Creekmore, we nevertheless find that a RICO case has not been made out against them because plaintiffs have failed to prove that they conducted the affairs of the Co-op through a pattern of racketeering activity. In Sedima v. Imrex, 105 S.Ct. 3275 (1985) the Supreme Court observed in passing that the lower federal courts had failed to develop a meaningful definition of "pattern" in RICO cases, a failing, we submit, for which Congress is primarily liable, having authored the legislation without defining a critical term. That the Sedima court would footnote this issue, one which was not raised by the questions raised in the certiorari petition, nor certified by the court for review, is an indication that the court was troubled by the indiscriminate use of RICO by

plaintiffs victimized by otherwise unremarkable frauds.

We are persuaded by two recent Eight Circuit opinions that plaintiffs have failed to prove that the lawyers participated in the conduct of the Co-op through a pattern of racketeering activity. The earlier opinion of the two held that a single long-running scheme victimizing a single entity does not constitute a RICO pattern. Superior Oil Co. v. Fulmer, supra. The latter opinion held that multiple parties separately victimized by activities relating to a single transaction are confined to their common law remedies since a showing of activity connected with a single transaction negates a finding of a "pattern" of racketeering activity. Holmberg v. Morrissette, supra.

In Superior Oil Co. v. Fulmer, Supra., three individuals siphoned natural

gas from a pipeline for refining and resale, covering up their misdeeds by posting a number of fraudulent meter readings through the mail. There was no evidence that the three committed other acts of the same tenor, or that they had ever attempted to do so. The court of appeals reversed a jury verdict finding the three liable for damages under RICO saying:

> "...[P]roof of a 'pattern of racketeering activity' 'requires more than one "racketeering activity" and the threat of continuing activity to be successful. It is this factor of continuity plus relationship which combines to produce a pattern.' ...Superior Oil clearly has proved the 'relationship' prong. They proved several related acts of mail and wire fraud in pursuit of the underlying conversion or theft of gas from Superior Oil's interstate pipeline....
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> Superior Oil has, however, failed to prove the 'continuity' sufficient to form 'a pattern of racketeering activity'. The actions of Fulmer, Branch and Nichols comprised one continuing scheme to convert gas from Superior Oil's

> pipeline. There was no proof that Fulmer, Branch or Nichols had ever done these activities in the past and there is no proof that they were engaged in criminal activities elsewhere.
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> Superior Oil attempted to show that Fulmer, Branch and Nichols intended to engage in similar gas conversion schemes at other locations. Although it may be that proof of a threat of continuing racketeering activities in the future could, in combination with ongoing acts of racketeering, be sufficient to establish a 'pattern of racketeering,' we find insufficient proof of such a threat here."

The Fulmer court, in short, agreed with Northern Trust Bank/-O'Hare N.A. v. Inryco, Inc., 615 F.Supp. 828, 832 (N.D. Ill. 1985) which said that "[i]t is difficult to see how the threat of continuing activity stressed in the Senate Report could be established by a single criminal episode," noting that "[i]t places a real strain on the language to speak of a single fraudulent effort, involving

several fraudulent acts, as a 'pattern of racketeering activity'."

We view Superior Oil as imposing a "single scheme" limitation on civil RICO cases. Where repetitive criminal activity expresses itself in a single fraudulent effort, the victim will be left to his common law fraud remedies, just as he was in pre-RICO days, We read Superior Oil to hold that the federal interest is ignited only when a party mounts repetitive efforts in distinct episodes.

Whatever doubts we may have entertained about Superior Oil's single scheme limitation were removed by the Eighth Circuit's more recent decision in Holmberg v. Morrissette, supra. The court of appeals decided that the trial court erred in holding the defendant liable under RICO where the plaintiff (one of three parties each of whom was separately

defrauded by the defendant,) was held to have been victimized only in connection with a single scheme, and not otherwise in connection with a pattern of racketeering activity. In Holmberg, three letters of credit, issued by the victims, separately secured the defendant's interest in a business transaction involving an exporter. To avoid a loss, defendant forged invoices and bills of lading to draw down the letters of credit. Even though the Holmberg facts (three separate acts, three different victims) differed from Fulmer's (one continuous siphoning, one victim), the Eighth Circuit declined to characterize this departure as material for purposes of civil RICO. The court said:

> "This court thoroughly discussed the parameters of 'pattern' in Superior Oil Co. v. Fulmer... In Superior Oil, we held that several related acts of mail and wire fraud as a part of a single scheme to divert natural gas ... did not amount to a

> racketeering activity. There was no evidence suggesting that such activities had occurred previously or that the individuals involved were engaged in other criminal activities....We believe the present case is legally indistinguishable from Superior Oil...
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> ....
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> We assume for purposes of our review that Holmberg proved that defendants committed acts of wire or mail fraud related to a common purpose or scheme. Our review of the record convinces us, however, that Holmberg has failed, as a matter of law, to prove the continuity necessary to form a 'pattern' of racketeering activity. Defendants' actions comprised one scheme to draw down the three letters of credit securing Mintex's transactions with TransWorld with respect to goods specially produced by Mintex....In one sense defendants' actions were a misguided attempt to obtain payment for goods which they had produced, yet over which they had no control."

In this case, the evidence suggests that the lawyers combined to unload the gasohol plant on the Co-op. There is but one scheme. The plaintiffs' expressed theory of the case, as manifested

in the Consolidated Complaint, charged all the defendants with "a [single] scheme to allow the Co-op to continue in existence, notwithstanding the depletion of its assets by looting". (Complaint ¶158). Somewhat tardily, plaintiffs suggest now that RICO case can be made against the lawyers because they twice victimized the Co-op: once to secure payment of White's legal fees, and once to transfer White's gasohol plant out of his hands.

One need only examine plaintiffs' introduction to its response to Ball and Mourton's motions for summary judgment to find expressed by plaintiffs their own view that the allegedly wrongful acts of the lawyers swung on a single pivot: the December 11, 1980, meeting of the Co-op Board. There Creekmore secured the authority to file both the declaratory judgment action, as well as a resolution

authorizing the Co-op to pay the legal fees of White and Kuykendall. From that one meeting emerged a single victim (the Co-op) allegedly bilked by a single fraudulent device (fiduciaries serving masters with conflicting interests) for the direct benefit of one party (White). Collateral benefits flowed to others, of course, but that fact is unimportant to this analysis.

The allegedly fraudulent activities in this case took place at one time and involved the same people. We do not believe that the Congress's concern that only continuing, repetitively manifested activities be redressed by RICO will be served if we indulge pleading fictions that balkanize essentially unitary transactions. The Eighth Circuit has twice clearly spoken against creative analyses of transactions that "plead defendants into RICO." A common sense view of the record

seems to be clearly called-for. Where a single scheme appears, plaintiffs should be left to their common law remedies, unless the plaintiffs can show that the defendants "did it before and would do it again." In such an event, RICO manifestly has its place, and needs no artful pleading to secure it.

Even if the law allowed plaintiffs to make two schemes out of a single meeting of the Board, we believe that the payment of legal fees by the Co-op is not such a cause of action as necessarily sounds in fraud. Our view of the trustee's suit in Count I is that the gravamen of the action is one for money paid by mistake, sounding in restitution. Indeed, the cases upon which we relied in sustaining the trustee's claim acknowledged that recovery could be obtained without a showing of _scienter_. Among the theories suggested by the

authorities as substantiating a claim in cases such as this one is "conversion" which, as Prosser notes, "defies definition," having its genesis in the law of trover, requiring only that plaintiff prove his right to possession and the defendant's exercise of dominion over the chattel. Prosser and Keeton, _Torts_, 5th Ed. 1984, pp. 88-90. We may at leisure criticize the expansion of "conversion" to reach the receipt of money; however, in so doing, we note a recognition by those courts that such a claim is one which, like conversion, does not require a pronounced mental element.

We therefore believe that a pattern of corrupt management of the Co-op has not been proved. We would emphasize that "management" by the lawyers has been assumed rather than found. We do not wish to intimate that attorneys are especially

prone to be found to control RICO enterprises simply by virtue of their calling. We suggest only that the question of "control" in this case is harder to reach than the question of pattern. Our findings, however, do not end our RICO inquiries, since plaintiffs have also charged that the lawyers and accountants operated their own firms as RICO enterprises, through a pattern of racketeering activity.[1]

Defendants E.J. Ball and Ken Mourton obviously participated in the management of the enterprise "Ball and Mourton." The individual Arthur Young accountants obviously participated in the management of Arthur Young. There is no

[1] [Creekmore was not charged with having operated his own practice in that manner; consequently, the RICO cause of action as to him is dismissed with no additional comment.]

proof in this record that either of these enterprises has been conducted through a pattern of racketeering activity. Rather, what we find is that to the extent that any of these lawyers' or accountants' dealings with the Co-op are wrongful, such dealings are aberrant, and in no way "typical" of the practice of these professionals.

We have mentioned our belief that the Superior Oil case imposed a scheme limitation on RICO. To the extent that an "outsider" directs or influences the affairs of an enterprise, we believe that RICO plaintiffs are obliged to show that he did so through a pattern of abuses. Such a pattern, we believe, cannot be found in events having a nexus to a single transaction. Such a limited showing simply does not permit a reasonable juror to conclude that the "outsider" intends to

pervert the enterprise into an ongoing, continuing engine of fraud.

If the person charged under RICO is an "insider" in his own "enterprise," it is even less likely, as the Sedima court suggested, that two acts or schemes will suffice to prove a pattern. A person acting through the enterprise of another obviously has fewer opportunities to influence its behaviour than he does when acting through his own. This is obviously true in the cases of large law firms and accountancy firms, which will have the opportunity to "manage", loosely speaking, the affairs of hundreds and thousands of clients at a time. In a large and varied practice,a person who twice corrupts a single "outside" enterprise will more likely be found to have managed that particular enterprise through a pattern of wrongful activity, than he would his own.

His "management" of the foreign enterprise may only consist of a limited number of transactions, and his readiness to exploit his association can be measured, quantitatively and qualitatively, against a much smaller range of activity. In such a case, two schemes may suffice.

When managing his own enterprise, wherein thousands of people are concerned and many times that many transactions are implicated, it is correspondingly harder reasonably to find a pattern of corruption arising out of only two discrete and widely separated acts. For example, if a professional service corporation were to send a single inflated bill to a client in 1973, and another to another client in 1982, it could hardly be said that it conducted its affairs through a pattern of racketeering activity. Sedima v. Imrex, supra, acknowledged the unreasonableness

of finding a pattern in such activity, without holding that a pattern can never be found from a showing of two acts or schemes. The court believes that it is possible to find that an individual managed an entity through a pattern of racketeering activity if his "management" were found to consist of a sufficiently limited number of discrete acts, two of which were distinctively and separately fraudulent. Obviously, however, where one acts through his own enterprise literally thousands of times a year, it beggars sense to require him to stand trial under RICO for two overbillings occurring nine years apart.

We believe that RICO claims are most likely to be predicated on "two schemes" when a court is convinced that the schemes are qualitatively and quantitatively significant enough so as to permit a reasonable jury to conclude that

they are somehow "characteristic" of the way a person conducts the affairs of an enterprise. If a person uses his business twice as an engine of fraud against the public in large scale securities offerings, the very distinctiveness of that behaviour may reasonably permit one to conclude that the defendant is determined to use his business as "a racket." By imposing a single scheme limitation on RICO, the courts are only forcing the statute to live up to its name. After all, any kind of fraudulent activity above the level of Three Card Monte will involve more than two acts of mail or wire fraud. An interpretation of RICO which permits every such scheme trebly to be redressed essentially invites every fraud case to be filed in federal court. This would especially be so if, as plaintiffs suggest, RICO frauds need be proved only by a

preponderance of the evidence, whereas common law frauds must be proved clearly and convincingly.

The record is devoid of proof that Ball and Mourton ever operated the affairs of Ball and Mourton so as to defraud any other party, and likewise that any of the individual accountants ever operated Arthur Young so as to defraud another. We therefore conclude that summary judgment must be entered on behalf of Ball, Mourton, Erwin, Cabannis, Drozal and Harrison. They neither controlled or managed the Co-op through a pattern of racketeering activity, nor their own firms. For these reasons as well, we dismiss Arthur Young's RICO crossclaims against the directors. Such claims, if they exist, clearly related to a single transaction or purpose, allegedly to keep the Co-op afloat.